No. 09-1417

IN THE

Supreme Court of the United States

UNITED RENTALS, INCORPORATED,

Petitioner,

v.

JAMES BIGELOW ANGELL,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

The United States Bankruptcy Code allows a trustee to avoid certain "preferential" transfers made prior to the petition date pursuant to 11 U.S.C. § 547(b). Among the elements of 11 U.S.C. § 547(b) is the requirement that the creditor received more than it would have received if the case were a case under chapter 7 of title 11 of the United States Code (the "Bankruptcy Code"); the transfer had not been made; and the creditor received payment of such debt as provided by the provisions of the Bankruptcy Code. 11 U.S.C. § 547(b)(5).

The Bankruptcy Code provides certain defenses to preferential transfers to creditors under 11 U.S.C. § 547(c), including the contemporaneous "new value" defense under 11 U.S.C. 547(c)(1). A successful assertion of this defense requires that the creditor show that the transfer was intended by the debtor and the creditor to be a contemporaneous exchange for new value given to the debtor; and in fact was a substantially contemporaneous exchange.

In this case, the Appellant, United Rentals, Incorporated ("United Rentals" or "Petitioner") was a lessor of construction equipment to the debtor, Partitions Plus of Wilmington, Inc. ("Partitions"), which served as a subcontractor on various construction projects. United Rentals was owed money on several projects. Although United Rentals had rights to assert claims against a bonding company (the "surety") to obtain payment of its claims or to exercise its rights to obtain liens against the projects under North Carolina law by complying with the statutory procedures to collect

money owed to it, United Rentals made absolutely no efforts to assert bond claims or to obtain statutory liens. United Rentals received payments from Partitions during the 90 day preference period. As Chapter 7 trustee, James B. Angell ("Trustee") brought suit under 11 U.S.C. §547(b) to recover the payments.

This case involves United Rentals' contentions that its unasserted bond claims, which might have resulted in equitable liens in favor of the surety, precluded the trustee from satisfying the provisions of 11 U.S.C.§ 547(b)(5); and that its unasserted bond claims and its unexercised rights to obtain liens under North Carolina law resulted in a new value defense under 11 U.S.C. § 547(c)(1).

Specifically, the questions presented in United Rentals' petition for certiorari are:

1) Does a conflict of law exist among the federal circuits regarding the Fourth Circuit's holding that United Rentals' unasserted bond claims on the construction projects did not enable the United Rentals to receive more than it would have received if the case were a case under chapter 7 of the Bankruptcy Code, the transfer had not been made and United Rentals received payment of such debt as provided under the provisions of the Bankruptcy Code, as is required to be shown under 11 U.S.C. § 547(b)(5)?

2) Does a conflict of law exist among the federal circuits regarding the Fourth Circuit's holding that United Rentals' unasserted bond claims did not result in a transfer intended by Partitions and United Rentals to be a contemporaneous exchange for new value given to Partitions and in fact was a substantially contemporaneous exchange, pursuant to 11 U.S.C. § 547(c)(1)?

3) Does a conflict of law exist among the federal circuits regarding the Fourth Circuit's holding that United Rentals' unexercised rights to obtain liens under North Carolina law did not result in a transfer intended by Partitions and United Rentals to be a contemporaneous exchange for new value given to Partitions and in fact was a substantially contemporaneous exchange, pursuant to 11 U.S.C. § 547(c)(1)?

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STATUTORY PROVISIONS INVOLVED

The Respondent adopts the Petitioner's statement of the Statutory Provisions Involved, however, Petitioner fails to set out the provisions of the North Carolina General Statutes relating to rights of subcontractors, suppliers and/or lessees to obtain liens against property involved in construction projects, as cited in the Fourth Circuit opinion. Those pertinent sections of these statutes are as follows:

N.C. GEN. STAT. § 44A-8. Mechanics', laborers', and materialmen's lien; persons entitled to claim of lien on real property

> Any person who performs or furnishes labor or professional design or surveying services or furnishes materials or furnishes rental equipment pursuant to a contract, either express or implied, with the owner of real property for the making of an improvement thereon shall, upon complying with the provisions of this Article, have a right to file a claim of lien on real property on the real property to secure payment of all debts owing for labor done or professional design or surveying services or material furnished or equipment rented pursuant to the contract.

N.C. GEN. STAT. § 44A-12. Filing claim of lien on real property

(a) Place of Filing. — All claims of lien on real property must be filed in the office of the clerk of superior court in each county where the real property subject to the claim of lien on real property is located. The clerk of superior court shall note the claim of lien on real property on the judgment docket and index the same under the name of the record owner of the real property at the time the claim of lien on real property is filed. An additional copy of the claim of lien on real property may also be filed with any receiver, referee in bankruptcy or assignee for benefit of creditors who obtains legal authority over the real property.

(b) Time of Filing. — Claims of lien on real property may be filed at any time after the maturity of the obligation secured thereby but not later than 120 days after the last furnishing of labor or materials at the site of the improvement by the person claiming the lien.

(c) Contents of Claim of Lien on Real Property to Be Filed. — All claims of lien on real property must be filed using a form substantially as follows:

CLAIM OF LIEN ON REAL PROPERTY

(1) Name and address of the person claiming the claim of lien on real property:

(2) Name and address of the record owner of the real property claimed to be subject to the claim of lien on real property at the time the claim of lien on real property is filed:

(3) Description of the real property upon which the claim of lien on real property is claimed: (Street address, tax lot and block number, reference to recorded instrument, or any other description of real property is sufficient, whether or not it is specific, if it reasonably identifies what is described.)

(4) Name and address of the person with whom the claimant contracted for the furnishing of labor or materials:

(5) Date upon which labor or materials were first furnished upon said property by the claimant:

(5a) Date upon which labor or materials were last furnished upon said property by the claimant:

(6) General description of the labor performed or materials furnished and the amount claimed therefor:

Lien Claimant

Filed this _____ day of _____, _____

Clerk of Superior Court

A general description of the labor performed or materials furnished is sufficient. It is not necessary for lien claimant to file an itemized list of materials or a detailed statement of labor performed.

(d) No Amendment of Claim of Lien on Real Property. – [omitted]

(e) Notice of Assignment of Claim of Lien on Real Property. – [omitted]

(f) Waiver of Right to File, Serve, or Claim Liens as Consideration for Contract Against Public Policy. – [omitted]

N.C. GEN. STAT. § 44A-10. Effective date of claim of lien on real property

A claim of lien on real property granted by this Article shall relate to and take effect from the time of the first furnishing of labor or materials at the site of the improvement by the person claiming the claim of lien on real property.

N.C. GEN. STAT. § 44A-13. Action to enforce claim of lien on real property

(a) Where and When Action Commenced. — An action to enforce a claim of lien on real property may be commenced in any county where venue is otherwise proper. No such action may be commenced later than 180 days after the last furnishing of labor or materials at the site of the improvement by the person claiming the claim of lien on real property. . . .

(b) Judgment. —A judgment enforcing a lien under this Article may be entered for the principal amount shown to be due, not exceeding the principal amount stated in the claim of lien enforced thereby. The judgment shall direct a sale of the real property subject to the lien thereby enforced.

(c) Notice of Action - [omitted]

N.C. GEN. STAT. § 44A-16. Discharge of record claim of lien on real property

Any claim of lien on real property filed under this Article may be discharged by any of the following methods:

(1), (2) [omitted]

(3) By failure to enforce the claim of lien on real property within the time prescribed in this Article.

(4), (5), (6) [omitted]

N.C. GEN. STAT. § 44A-18. Grant of lien upon funds; subrogation; perfection

Upon compliance with this Article:

(1) A first tier subcontractor who furnished labor, materials, or rental equipment at the site of the improvement shall be entitled to a lien upon funds that are owed to the contractor with whom the first tier subcontractor dealt and that arise out of the improvement on which the first tier subcontractor worked or furnished materials.

(2) A second tier subcontractor who furnished labor, materials, or rental equipment at the site of the improvement shall be entitled to a lien upon funds that are owed to the first tier subcontractor with whom the second tier subcontractor dealt and that arise out of the improvement on which the second tier subcontractor worked or furnished materials. A second tier subcontractor, to the extent of the second tier subcontractor's lien provided in this subdivision, shall also be entitled to be subrogated to the lien of the first tier subcontractor with whom the second tier

> contractor dealt provided for in subdivision (1) of this section and shall be entitled to perfect it by notice of claim of lien upon funds to the extent of the claim.

(3), (4), (5) [omitted]

(6) A lien upon funds granted under this section is perfected upon the giving of notice of claim of lien upon funds in writing to the obligor as provided in G.S. 44A-19 and shall be effective upon the obligor's receipt of the notice. The subrogation rights of a first, second, or third tier subcontractor to the claim of lien on real property of the contractor created by Part 1 of Article 2 of this Chapter are perfected as provided in G.S. 44A-23.

N.C. GEN. STAT. § 44A-23. Contractor's claim of lien on real property; perfection of subrogation rights of subcontractor.

(a) First tier subcontractor. — A first tier subcontractor, who gives notice of claim of lien upon funds as provided in this Article, may, to the extent of this claim, enforce the claim of lien on real property of the contractor created by Part 1 of this Article. The manner of such enforcement

shall be as provided by G.S. 44A-7 through 44A-16. The claim of lien on real property is perfected as of the time set forth in G.S. 44A-10 upon filing of the claim of lien on real property pursuant to G.S. 44A-12. Upon the filing of the claim of lien on real property, with the notice of claim of lien upon funds attached, and the commencement of the action, no action of the contractor shall be effective to prejudice the rights of the subcontractor without his written consent.

(b) Second or third subcontractor. –

(1) A second or third tier subcontractor, who gives notice of claim of lien upon funds as provided in this Article, may, to the extent of his claim, enforce the claim of lien on real property of the contractor created by Part 1 of Article 2 of the Chapter except when:

(a), (b) [omitted]

(2), (3) [omitted]

(4) The manner of such enforcement shall be as provided by G.S. 44A-7 through G.S. 44A-16. The

> lien is perfected as of the time set forth in G.S. 44A-10 upon the filing of a claim of lien on real property pursuant to G.S. 44A-12. Upon the filing of the claim of lien on real property, with the notice of claim of lien upon funds attached, and the commencement of the action, no action of the contractor shall be effective to prejudice the rights of the second or third tier subcontractor without his written consent.

STATEMENT OF THE CASE

The Respondent accepts Petitioner's statement of the case with the following corrections and clarifications:

United Rentals contends that the Fourth Circuit's decision in this case conflicts with the decisions of other circuits and creates an inequitable scenario where a construction contractor is prejudiced by accepting payment for its work. Petition for a Writ of Certiorari ("Brief"), p. 4. The prejudice of recovery of a preferential payment is no greater than that applicable to a general unsecured creditor, including a general unsecured creditor that could have obtained a judgment lien or other lien, but failed to do so.

United Rentals contends that there are clear conflicts between the decisions of other circuits and the Fourth Circuit. Brief, p. 5. As shown below, United Rentals has shown no conflicting decisions because the Fourth Circuit's decision was based on its undisputed finding that United Rentals never asserted a bond claim or took any action to obtain a lien under North Carolina's lien laws. Based on these findings, the Fourth Circuit found that United Rentals did not have a security interest in property of the estate and the surety providing the bond did not have an equitable lien against property of the debtor. The cases cited by United Rentals are generally based on facts where liens were provided by statute without conditions, the defendant exercised its rights to assert a lien under state law, or the defendant asserted a claim against the surety.

The Trustee disputes the contentions made by United Rentals concerning the consequences of the Fourth Circuit decision. Brief, pp. 5-6. The North Carolina lien statutes and payment bonds grant subcontractors such as United Rentals rights to exercise remedies if payment is not timely made. These protections are in place to allow creditors to assert priorities to protect themselves. The state law policies of assisting subcontractors in obtaining payment are determined by state law and are simply part of the substantive law that must be taken into account in determining rights in bankruptcy cases.

United Rentals asserts that North Carolina law gives a subcontractor "a lien on funds that are owed to the contractor", citing N.C. GEN. STAT. § 44A-18 (2010). Brief, p. 7. In citing the statue, United Rentals omits

the language in the statute providing conditions to the lien, that it is granted "(u)pon compliance with this Article" and requires service of a notice of the lien on the obligor. N.C. GEN. STAT. §44A-18(6). Similarly, United Rentals omitted that the claim of lien to be filed under N.C. GEN. STAT. §44A-12 is filed pursuant to the provisions of N.C. GEN. STAT. §44A-8 and N.C. GEN. STAT. §44A-23, which provide a mere "right to file a claim of lien on real property" "upon complying with the provisions of this Article", which is available to a subcontractor "who gives notice of claim of lien upon funds as provided in this Article." The liens are not effective and the subcontractor has no rights to these liens without compliance with these statutes.

United Rentals asserts that the evidence in the Bankruptcy Court showed that "owners and contractors on both projects were holding funds in excess of the alleged preferential payments both at the time of the transfers and at the time of the bankruptcy petition." Brief, p. 10. The Bankruptcy Court made no such finding and merely found that "the only evidence that United Rentals presented at trial . . . [was] whether there were sufficient funds owing to the debtor general contractor on which the bonding company could have asserted a lien." App. D, p. 37a.

REASONS FOR DENYING THE PETITION

I. *Summary of the decision below.*

The Fourth Circuit's decision, App A (the "Fourth Circuit Decision") is expressly based on its affirmation of the Bankruptcy and District Courts' findings that United Rentals was an unsecured creditor when the payments were received. App. A, pp. 13a, 15a. United Rentals did absolutely nothing to exercise its rights under North Carolina law to obtain liens against the projects, and United Rentals took no actions to assert any claims against the bonding company based on payment bonds for the projects. App. A, p. 6a.

In its Petition, United Rentals argues that there are conflicts between the circuits as to issues under 11 U.S.C. § 547(b)(5) (hereinafter "§ 547(b)(5)") and 11 U.S.C. §547(c)(1) (hereinafter "§547(c)(1)"). Brief, pp. 15-32. However, a review of the cases cited by United Rentals shows that the creditors in those cases had taken some action to assert claims against the bonding companies or were entitled to existing liens under the applicable state statutes. The cases cited by United Rentals are therefore distinguishable on their facts, and no real conflict exists.

The Fourth Circuit addressed the lien law issues based on its reading of the North Carolina statutes, App. A, pp. 14a-17a, which is facially consistent with the language of those statutes, and not in conflict with any North Carolina precedents.

The Fourth Circuit's findings with respect to the bond claims are simply based on the fact that no bond claims were asserted by United Rentals and are consistent with precedent that a surety's equitable lien rights arise upon payment. App. A, p. 13a. The cases cited by United Rentals involve asserted bond claims or other secured claims existing at the time of payment and do not apply to the facts in this case, in which no bond claims were asserted.

Therefore, there is no conflict with the other circuits as argued by United Rentals because the cases it cites involve creditors who made claims on bonds or had existing liens under applicable state law.

A. *The Fourth Circuit's Finding as to Property Rights regarding United Rentals' Bond Claims.*

United Rentals did not contend and does not now contend that it took any actions to assert any claims against the surety under the bonds.

United Rentals asserted, in support of its argument that the Trustee failed to establish the requirements of § 547(b)(5) and its new value defense under § 547(c)(1) that it had claims against the surety based on payment bonds on the various projects. App. A., pp. 5a, 6a. Its argument under § 547(b)(5) was that, had it asserted claims against the surety, the surety would have paid the claims in full. App. A, p. 9a. Its argument under § 547(c)(1) was that payment resulted in money that Partitions received from general contractors that might have been instead paid to the surety had the surety paid a bond claim. App. A, p. 13a.

In rejecting United Rentals' arguments under §547(c)(1), the Fourth Circuit addressed the basis of United Rentals' contentions regarding the surety's property rights directly: "Since United never even attempted to make any claim on the bond here, the Surety never obtained any lien that it could release . . . the only benefit that United showed the Debtor was given, as part of the contemporaneous exchange for the transfers, was the extinguishment of its debt." App. A. pp. 13a, 14a.

B. *The Fourth Circuit's Finding as to Property Rights regarding United Rentals' Rights to Obtain Liens under North Carolina Law.*

United Rentals did not contend and does not now contend that it took any actions to exercise its rights to obtain a lien under North Carolina's lien statutes.

United Rentals did not present the issue of whether its unexercised rights to obtain liens under North Carolina law defeated the requirements of § 547(b)(5) at trial and that issue was not considered on appeal. App. A, p. 9a, n.2.

United Rentals argued under § 547(c)(1) that new value was given to the debtor in the form of money that Partitions retained by not having to face offset claims that would result if United Rentals exercised its lien rights. App. A, pp. 14a, 15a. United Rentals also argued that new value was given in the discharge of its inchoate lien rights under North Carolina law. App. A, p. 15a. In support of its arguments, United Rentals argued that North Carolina law provided it with a security interest

in the owners' property at the time of the transfers. App. A, p. 15a.

The Fourth Circuit addressed these contentions directly. "United claims that it held a security interest in the owners' properties at the time of the transfers . . . because the mechanic's lien statutes immediately grant a security interest to a supplier who furnishes labor or material to improve the property . . . However, just as the Surety did not have an equitable lien to release since it had not paid a claim on the bond, United did not have a security interest to release because it never filed the mechanic's lien claim necessary to obtain such an interest . . . Because United had not filed such a claim when the transfers were made, no interest had been transferred to United and United had no interest to release." App. A, pp. 15a-17a.

C. *The Fourth Circuit's Ruling under §547(b)(5) regarding United Rentals' unasserted bond claims.*

The Fourth Circuit found, with respect to §547(b)(5), the "inquiry focuses 'not on whether a creditor may have recovered all of the monies owed by the debtor *from any source whatsoever*, but instead upon whether the creditor would have received less than a 100% payout' from the bankruptcy estate." App. A, pp. 9a, 10a. Since United Rentals' argument was that it would have received payment from the surety had it not been paid and asserted a bond claim, and not that it would have received full payment from Partitions of its claims as provided under the provisions of the Bankruptcy Code, the Fourth Circuit upheld the lower court rulings.

D. *The Fourth Circuit's Ruling under §547(c)(1) regarding United Rentals' unasserted bond claims.*

The Fourth Circuit addressed United Rentals' contentions that United Rentals' unasserted claims against the bonds resulted in an "indirect transfer" of new value under § 547(c)(1) based on the money that Partitions was eventually paid that the surety could have received directly from the general contractor had United Rentals enforced its bond rights.[1] App. A, pp. 11a, 12a, citing *O'Rourke v. Seaboard Surety Co. (In re Fegert, Inc.)*, 887 F.2d 955 (9th Cir. 1989). The Fourth Circuit found that "without deciding the correctness of the *Fegert* court's conclusion that the release of the surety's security interest in that case constituted "new value" contemporaneously received by the debtor, we conclude that that was not the case on the facts before us" because "United never even attempted to make any claim on the bond here" such that the surety never had any interest it could release. App. A, p. 13a.

The Fourth Circuit also reasoned that the value in the form of money that might eventually be received by Partitions from the general contractors that otherwise might have been paid to the surety could not be contemporaneous exchange of new value because it could not be shown when these funds might be received. App. A, pp. 13a - 14a. The Fourth Circuit also held that

[1] The Fourth Circuit found that United Rentals "does not even argue to us that the Debtor received new value by virtue of the removal of the possibility that any such lien would ever be created." App. A, p. 13a.

United Rentals had produced no evidence that Partitions and United Rentals intended the transfer as a contemporaneous exchange of new value. App. A, p. 14a.

E. *The Fourth Circuit's Ruling under §547(c)(1) regarding United Rentals' unexercised rights to obtain liens under North Carolina law.*

In ruling against United Rentals' contentions that its unexercised rights to obtain liens under North Carolina law resulted in a "new value" defense under §547(c)(1), the Court found that "just as the Surety did not have an equitable lien to release since it had not paid a claim on the bond, United did not have a security interest to release because it never filed the mechanic's lien claim necessary to obtain such an interest." App. A, p. 15a.

Finally, the Fourth Circuit rejected United Rentals' contentions that the Debtor retained money by not having to face offset claims that the property owner would have gained from enforcement of United Rentals' rights under North Carolina law to obtain a lien, and that discharge of United's inchoate lien rights constitutes new value. App. A, p. 15a. The basis of its decision was that "United never had a security interest to release because it never filed the mechanic's lien claim necessary to obtain such an interest" under North Carolina law. App. A, p. 15a.

II. *The Fourth Circuit decision is not in conflict with the cases from other circuits cited by United Rentals because those cases involve creditors who asserted bond claims or had existing lien rights under applicable state law.*

The decisions of other Circuits cited in United Rentals' Brief are generally distinguishable from the Fourth Circuit decision below because they are based on bond claims that were actually asserted or lien remedies that were actually exercised or otherwise involved liens that existed when the payment was made. Because of these factual distinctions, there is no conflict among the circuits. As to the lien laws, the findings of the Fourth Circuit are based on the specific provisions of North Carolina's lien statutes, are not in conflict with the North Carolina decisions cited by United Rentals, and do not raise issues of general applicability across the circuits.

In its Brief, United Rentals further obscures the issue involved in the Fourth Circuit decision by failing to distinguish between its arguments posed in the courts below under §547(b)(5) and §547(c)(1).

A. *The Fourth Circuit decision under §547(b)(5) relating to United Rentals' unasserted bond claims is consistent with the decisions of the Sixth Circuit and other circuits.*

In holding that "the § 547(b)(5) inquiry focuses 'not on whether a creditor may have recovered all of the monies owed by the debtor *from any source whatsoever*, but instead upon whether the creditor would have

received less than a 100% payout' from the bankruptcy estate," the Fourth Circuit treated United Rentals as an unsecured creditor. App A, pp. 9a, 10a (*citing Smith v. Creative-Financial Mgmt., Inc. (In re Virginia-Carolina Fin. Corp.)*, 954 F.2d 193, 199 (4th Cir. 1992)).

Under § 547(b)(5), the Court must determine that the transfer enables such creditor to get more than he would receive if (A) the case were a case under chapter 7 of the Bankruptcy Code; (B) the transfer had not been made; and (C) such creditor received payment of such debt to the extent provided by the provisions of the Bankruptcy Code. In making its determination, the court must decide the transferee's creditor class and determine what distribution that class would have received had the transfer not been made. *See* 11 U.S.C. §§ 506, 726(a).

United Rentals argues that there is a conflict among the circuits based on different statements of the legal standard as whether a voidable preference must diminish the estate as opposed to whether a creditor would have received less than a 100% payout' from the bankruptcy estate. Brief, pp. 17-18. This presents a false choice to the Court and a false conflict. Although, the diminishment rule generally applies in determining whether § 547(b)(5) applies, the 100% rule is a special application of that rule applicable to unsecured claims, such as the claims of United Rentals in this case. In fact, these principles are completely consistent in the case of a general unsecured claim, as set out in *Palmer Clay*

Products Co. v. Brown, 297 U.S. 227 (1936), a case decided under the Bankruptcy Act:

> Whether a creditor has received a preference is to be determined . . . by the actual effect of the payment as determined when bankruptcy results. The payment on account of say 10% within the four months will necessarily result in such creditor receiving a greater percentage than other creditors, if the distribution in bankruptcy is less than 100%. For where the creditor's claim is $10,000, the payment on account $1000, and the distribution in bankruptcy 50%, the creditor to whom the payment on account is made receives $5500, while another creditor to whom the same amount was owing and no payment on account was made will receive only $5000. *A payment which enables the creditor "to obtain a greater percentage of his debt than any other of such creditors of the same class" is a preference.*

Id. at 229 (emphasis added).

Smith v. Creative-Financial Mgmt., Inc. (In re Virginia-Carolina Fin. Corp.), 954 F.2d 193, 199 (4th Cir. 1992) follows the *Palmer Clay* case and distinguishes between creditors having secured claims and those having unsecured claims. The *Smith* Court cites *Small v. Williams*, 313 F.2d 39, 44 (4th Cir. 1963), holding that, in the case of a secured claim, "payment upon a secured claim which has the effect of 'releasing assets of comparable value to the claims of general creditors is

not preferential because it does 'not deplete the debtor's estate or diminish the assets available for distribution among general creditors." The *Smith* Court in addressing the preference payments made to an unsecured creditor, as in this case, found that the applicable standard under §547(b)(5) was whether the creditor would have received less than a 100% payout in Chapter 7 liquidation." 954 F.2d at 199. The conflict between the circuits alleged by United Rentals is based on a misreading of these cases.

Cases within the Fifth, Sixth, Seventh, Eighth, Tenth and Eleventh circuits, cited by United Rentals as being in conflict with the Fourth Circuit, use the same rules for determining whether a transfer has a preferential effect under § 547(b)(5): In the case of a payment to an unsecured, nonpriority creditor, the preferential effect requirement is satisfied unless general, unsecured creditors would have received 100% of their claims in the hypothesized Chapter 7 distribution. *Compare Smith v. Creative-Financial Mgmt., Inc.*, 954 F.2d 193, 199, *with Lowe v. Palmetco, Inc. (In re NA Flash Found., Inc.)*, 541 F.3d 385, 389 (5th Cir. 2008) (stating that the preference statute was designed "to prevent a transfer to one creditor that would diminish the estate of the debtor" applying "the relevant inquiry focuses not on whether a creditor may have recovered all of the monies owed by the debtor from any source whatsoever, but instead on whether the creditor would have recovered 100% of the debt from the debtor's estate."); *Still v. Rossville Bank (In re Chattanooga Wholesale Antiques, Inc.)*, 930 F.2d 458, 465 (6th Cir. 1991) ("Unless the estate is sufficient to pay a 100% distribution, any unsecured creditor . . . who

receives a payment during the preference period is in a position to receive more than it would have received in a chapter 7 liquidation."); *Maxwell v. Amtex Systems, Inc. (In re marchFirst, Inc.)*, 2007 Bankr. LEXIS 4761 (7th Cir. Bankr. N.D. Ill. 2007)(the issue is whether "unsecured creditors would have received less than 100% of their claims."); *In re Kroh Brothers Development Co.*, 86 B.R. 186 (8th Cir. Bankr. W.D. Mo. 1988), *aff'd* 973 F.2d 671(8th Cir. 1992) ("if distribution in bankruptcy to unsecured creditors is less than 100 percent, any payment to an unsecured creditor during the preference period enables that creditor to receive more than he would have received in liquidation had the payment not been made"); *Connolly v. Fiber Instrument Sales, Inc. In re Western Integrated Networks, LLC)*, 2006 Bankr. LEXIS 2970, 46 Bankr. Ct. Dec. (LRP) 281 (B.A.P. 10th Cir. 2006) ("Fortunately, the courts have recognized certain shorthand tests for deciding if a transfer had a preferential effect. The most commonly used test is as follows: In the case of a payment to an unsecured, nonpriority (general) creditor, the preferential effect requirement is satisfied unless general, unsecured creditors would have received 100% of their claims in the hypothesized Chapter 7 distribution."); *Flatau v. Tribble's Shoes, Inc. (In re Lawrence)*, 82 B.R. 157, 160 (11th Cir. Bankr. M.D. Ga. 1988)(the issue is whether "Plaintiff has shown that a one hundred percent distribution to unsecured creditors is not possible."). These cases demonstrate that the 100% test applicable to unsecured creditors is an application of the general "diminution" rule and that the two rules are compatible and not in conflict.

Although United does not contend it was a secured creditor for the purposes of § 547(b)(5), it contends that, although it did nothing whatsoever to assert its bond claim, it should be entitled to assert the equitable subrogation rights available to a surety as described in the case of *Pearlman v. Reliance Insurance Company*, 371 US. 132 (1962). Brief, pp. 18, 19. It contends that these equitable subrogation rights would have resulted in no diminishment of the estate because these rights would have resulted in the surety being fully secured in the amount of the payment. Brief, pp. 18, 19.

Pearlman itself is distinguishable from the facts of this case. *Pearlman* involved a surety that paid for the completion of a bonded project, and asserted that its equitable rights to the contract balance were superior to those of the bankruptcy trustee. *Pearlman*, 371 U.S., at 133-134. The Supreme Court cited the "already established doctrine that a surety who completes a contract has an "equitable right" to indemnification out of a retained fund . . . here the surety incurred his losses by paying debts for the contractor rather than by finishing the contract. *Id.* at 138. In this case, United Rentals accepted payment from the debtor instead of receiving payment from the surety. *Id.* The equitable lien of the surety ever came into effect. App. A, p. 13a.

United Rentals cites *O'Rourke v. Seaboard Surety Co. (In re Fegert, Inc.)*, 88 B.R. 258 (B.A.P. 9th Cir. 1988) to support its assertion that its unexercised bond claims resulted in "new value" under § 547(c)(1), Brief, p. 24. In this context, the Fourth Circuit recognized the *Fegert* decision as holding that "the release of the surety's security interest in that case constitutes 'new value'

contemporaneously received by the debtor," but concluded "that that was not the case on the facts before us . . . since United never even attempted to make any claim on the bond . . . the Surety never obtained any lien that it could release." App. A, p. 13a.

United Rentals misstates the basis of the Fourth Circuit decision. First, the Fourth Circuit holds that the court must look solely to the payment that the creditor would receive from the estate, not from the surety.

Even applying United Rentals' "indirect transfer" theory to § 547(b), as it seems to argue in claiming that the estate was not diminished, the Fourth Circuit did not find that § 547(b) is "satisfied when the estate would not be diminished by the transfers." Brief, p. 23. The Fourth Circuit found that the basis of United Rentals' assertion that the payment did not diminish the estate, *i.e.*, the surety's equitable lien, did not exist because United Rentals never filed a bond claim. As such, United Rentals was treated as an unsecured creditor and the 100% rule applied. The cases cited by United Rentals that apply to secured claims of preference defendants or sureties simply do not apply in this case because there were no secured claims involved in this case.

Since United Rentals did nothing to assert its claims against the sureties in this case, United Rentals' reliance on *Pearlman* and *Fegert* is misplaced. As such, it is an unsecured creditor in the debtor's bankruptcy case and the surety did not obtain the equitable lien rights found to exist in those cases. The 100% standard applicable to nonpriority unsecured creditors is consistent with the diminution standard generally applied to determine the

preferential effect of the transfer under § 547(b)(5) in the Fifth, Sixth, Seventh, Eighth and Tenth circuits. There is no conflict between the circuits based on the facts in this case.

B. *The Fourth Circuit's decision did not address whether United Rentals' unexercised lien rights under North Carolina law resulted in no diminution of the estate under § 547(b) because United Rentals failed to preserve the issue for appeal.*

United Rentals argues "The Fourth Circuit has rejected and is in conflict with [the] decisions of the Second and Ninth Circuits holding that there is no preferential transfer if unperfected state law inchoate mechanic's lien rights are released, resulting in no diminution of the estate." Brief, p. 32.

This issue was not raised by United Rentals in the Bankruptcy Court on the Trustee's motion for summary judgment under § 547(b), App. E, pp. 43a-48a, and this issue was not considered by the Fourth Circuit. The Fourth Circuit found that United Rentals failed to preserve the issue of whether, under §547(b)(5), "had the transfers not been made, United would . . . have obtained full payment from the hypothetical Chapter 7 estate by enforcing its lien rights and thereby attaining secured-creditor status." App. A, p. 9a, n.2. As noted by the Fourth Circuit, United Rentals based its argument at the summary judgment hearing on §547(b) on whether the transfers were avoidable "because United would have received full payment from the Surety by enforcing its bond rights had the Debtor not made the

transfers." App. A, p. 5a, App. E, pp. 47a, 48a. This Court should not indulge United Rentals' efforts to raise this issue once again on a petition for certiorari where it was not preserved at the trial court level.

C. *The Fourth Circuit decision under §547(c)(1) relating to United Rentals' unasserted bond claims is consistent with the decisions of the Sixth Circuit and other circuits.*

As noted above, the Fourth Circuit rejected United Rentals' contention that the surety had a lien based on equitable subrogation where United Rentals did nothing to assert a bond claim. App. A, p. 13a.

Despite United Rentals' best efforts to portray the Fourth Circuit decision in this case as in conflict with the *O'Rourke v. Seaboard Surety Co. (In re Fegert, Inc.)*, 887 F.2d 955 (9th Cir. 1989) decision in the Ninth Circuit, Brief, p. 23-26, the Fourth Circuit decision identified a factual basis for distinguishing the Ninth Circuit decision in the *Fegert* case. In fact, the Fourth Circuit scrupulously reserved the issue for another day, in making its ruling "[w]ithout deciding the correctness of the *Fegert* court's conclusion that the release of the surety's security interest in that case constituted 'new value' contemporaneously received by the debtor." App. A, p. 13a.

The facts in *Fegert* are distinguishable from the facts in this case. In *Fegert*, the subcontractors sued the debtor and the surety for payment of their claims. In this case, "United never even attempted to make any claim on the bond". App. A, p. 13a. Had United Rentals

made a claim on the bond by filing suit, the Fourth Circuit would have been squarely presented with the *Fegert* issue. Similarly, *Fegert* is not controlling in the Ninth Circuit where the subcontractor has not made a claim on the bond. Because the Fourth Circuit found that the surety never had a lien that it could release due to United Rental's failure to even make a claim on the bond, the decisions are based on different facts and are not in conflict.

Similarly, United argues that the Fourth Circuit decision is contrary to the Fifth Circuit decision of *Gulf Oil Corporation v. Fuel Oil Supply & Terminating, Inc. (In re Fuel Oil Supply & Termininating, Inc.)*, 837 F.2d 224 (5th Cir. 1988) and the Ninth Circuit decision of *Committee of Creditors holding Unsecured Claims v. Koch Oil Company (In re Powerine Oil Company)*, 59 F3d 969 (9th Cir. 1995) *cert. denied* 516 US 1140 (1996). Brief, pp. 27-29. Both of these decisions involved facts in which the creditor had the right to call a letter of credit that was secured by an existing lien on property of the estate. In this case, the Fourth Circuit held that there was no lien created in favor of the Surety that could be released. App. A, p. 11a. These cases are therefore distinguishable on their facts, and there is no conflict between these decisions and the Fourth Circuit's decision.

D. *The Fourth Circuit's decision under § 547(c)(1) relating to United Rentals' unexercised rights to obtain liens under North Carolina law is not in conflict with the decisions of the Supreme Court or the Circuit courts applying the lien laws of other states.*

United Rentals again seeks to obscure a ruling on the facts of this case in contending that the Fourth Circuit decision is in conflict with other circuits. With regard to United Rentals' claims under § 547(c)(1), the Fourth Circuit held, that "just as the Surety did not have an equitable lien to release since it had not paid a claim on the bond, United did not have a security interest to release because it never filed the mechanic's lien necessary to obtain such an interest." App. A, p. 15a.

United Rentals contends that the use of the term "inchoate" by the North Carolina courts in describing rights to obtain liens under Chapter 44A of the North Carolina General Statutes is conclusive on the federal court in determining that a lien presently exists. Brief, pp. 29-30. United Rentals completely miscites *United States v. Security Trust & Savings Bank*, 340 U.S. 47 (1950) to support its position that its unexercised lien rights under North Carolina law resulted in a lien. Brief, p. 29. Specifically, *Security Trust* states that:

> The effect of a lien in relation to a provision of federal law for the collection of debts owing the United States is always a federal question. Hence, although a state court's classification of a lien as specific and perfected is entitled to weight, it is subject to reexamination by

> this Court. On the other hand, *if the state court itself describes the lien as inchoate, this classification is "practically conclusive." Illinois v. Campbell*, 329 U.S. 362, 371. The Supreme Court of California has so described its attachment lien in the case of *Puissegur v. Yarbrough*, 29 Cal. 2d 409, 412, 175 P. 2d 830, 831, by stating that, "*The attaching creditor obtains only a potential right or a contingent lien . . .*"

Security Trust, 340 U.S. at 49-50 (emphasis added).

In *Illinois ex rel. Gordon v. Campbell*, 329 U.S. 362 (U.S. 1946), cited in *Security Trust*, the Supreme Court was called upon to review a decision of the Illinois Supreme Court that a federal lien was superior to a lien arising under Illinois law. The Illinois Supreme Court had held that the lien under Illinois law was "inchoate" such that the federal lien enjoyed priority. 329 U.S. at 371. The Court held:

> The priority given the United States cannot be impaired or superseded by state law." *United States v. Oklahoma*, 261 U.S. 253, 260. Hence a state court's characterization of a lien as specific and perfected is not conclusive. *United States v. Waddill Co.*, 323 U.S. 353, 357. The state characterization, though entitled to weight, is always subject to reexamination by this Court.
>
> On the other hand, if the state court itself characterizes the lien as inchoate, this

> characterization is practically conclusive. "Whatever might have been the effect of more completed procedure in the perfecting of the liens under the law of the State, upon the priority of the United States herein, the attitude of the state court relieves us of consideration of it." *Spokane County v. United States*, 279 U.S. 80, 95; *cf. United States v. Knott*, 298 U.S. 544.

Id. What the Court was saying was that if the state court finds that the lien is "inchoate", the federal court may consider the lien to be unperfected without further inquiry.[2]

Although the North Carolina cases cited by United Rentals use the term "inchoate" in describing the liens, United Rentals cites no case under North Carolina law finding that an "inchoate" materialman's lien is a presently effective lien. Brief, pp. 29, 30. The use of the term "inchoate" in North Carolina decisions is without any definition in terms of its effectiveness or priority, it is simply a short-hand manner of describing a materialman's rights to obtain a lien by complying with the provisions of the North Carolina statutes, whatever those rights may be. *See* App. A, pp. 15a-17a. As to the Fourth Circuit's characterization of the rights are a "right to file a mechanic's lien", the Fourth Circuit is

[2] Although United Rentals asserts that an "inchoate" lien is an existing interest, an "inchoate interest" is a "property interest that has not yet vested". *Rossiter v. Simon (In re Rossiter)*, 412 B.R. 677, 683 (D.N.J. 2008)(citing Black's Law Dictionary 816 (7th ed. 1999)).

merely tracking the language of N.C. GEN. STAT. § 44A-8, holding that a contractor "shall, *upon complying with the provisions of this Article*, have a *right to file a claim of lien on real property* on the real property to secure payment for all debts owing for" services performed, materials provided, or leased property. *See also* N.C. GEN. STAT. § 44A-23(b)(1) ("A second or third tier subcontractor, *who gives notice of claim of lien upon funds as provided in this Article, may,* to the extent of his claim, enforce the claim of lien on real property of the contractor . . .").

United Rentals contends that the Second Circuit's decision in *Ricottta v. Burns*, 264 F.2d 749 (2d. Cir. 1959) results in a conflict with the Fourth Circuit decision. Brief, pp. 30, 31. Although *Ricotta*, decided under the Bankruptcy Act, found that the trustee could not avoid a payment for building materials furnished to a bankrupt debtor where the defendant could have filed a materialman's lien for the same debt under New York's lien law, subsequent decisions in the Second Circuit have rejected that the analysis in the *Ricotta* case applies to the "new value" defense under §547(c)(1), *Official Comm. of Unsecured Creditors of 360Networks (USA) Inc. v. AAF-McQuay, Inc. (In re 360 Networks (USA), Inc.)*, 327 B.R. 187, 191 (Bankr. S.D.N.Y. 2005) ("Contrary to the Debtors' contention, *Ricotta* was not decided on the basis of a new value argument and, in fact, the decision makes no mention of new value.") or that *Ricotta* applies where the lien asserted under New York is asserted against property that is not the debtor's property, *Buchwald Capital Advisors, L.L.C. v. Metl-Span I, Ltd. (In re Pamleco Corp.)*, 356 B.R. 327, 336 (Bankr. S.D.N.Y. 2006)("*Ricotta* . . . dealt with a

statutory lien that would have been imposed directly upon the debtor's property and [is] inapposite under the facts of this case."). In fact, the *360Networks* decision expressly holds that the release of a right to perfect a lien is not included in the Bankruptcy Code's definition of "new value." *360Networks*, 327 B.R. at 192.

The basis of the Second Circuit's decision in *Ricotta*, as clarified by these cases, is important in that it demonstrates that the facts are distinguishable from the present case, in which United Rentals asserts it could have filed liens against property owned by others. Brief, pp. 7-8. Subsequent decisions make it clear that the Second Circuit has not passed on the issue of whether unexercised lien rights constitute "new value" under § 547(c)(1)[3]; and that the Second Circuit has not passed on the issue of whether unexercised rights to obtain liens on property other than property of the debtor under applicable state law constitutes new value. The *Ricotta* decision in inapposite to the issues decided in the Fourth Circuit's decision.

Although United Rentals cites *Miller v. Wells Fargo Bank International Corp.*, 540 F.2d 548 (2d Cir. 1976) as another decision in conflict with the Fourth Circuit decision, Brief, p. 31, this case does nothing more than distinguish the bank liens involved in that case from those involved in *Ricotta*. As such, *Miller* simply cites *Ricotta* and distinguishes it without adding to the legal analysis of the Second Circuit as to these issues. 540 F.2d at 564, 565.

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[3] Solely for the sake of making this point, the Trustee ignores that there may be distinguishing differences between North Carolina's lien laws and those of New York.

The Ninth Circuit's decision in *Greenblatt v. Utley*, 240 F.2d 243 (9th Cir. 1956) cited by United Rentals as another conflicting circuit, Brief, pp. 31, 32, is factually distinguishable based on the broad lien granted by California law. Instead of providing a subcontractor with a "right to file a lien", as provided under North Carolina law, App. A, pp. 16a-17a, the California statute applicable in that case provided that:

> 'Liens of construction mechanics, materialmen, contractors, etc. — Mechanics, materialmen, contractors, subcontractors, artisans, architects, machinists, builders, teamsters and draymen, and all persons and laborers of every class performing labor upon or bestowing skill or other necessary services on, or furnishing materials to be used or consumed in, or furnishing appliances, teams, or power, contributing to, the construction, alteration, addition to, or repair, either in whole or in part, of, any building, structure, or other work of improvement ***shall have a lien upon the property*** upon which they have bestowed labor or furnished materials or appliances for the value of such labor done or materials furnished and for the value of the use of such appliances, teams, or power, whether done or furnished at the instance of the owner or of any person acting by his authority or under

> him, as contractor or otherwise.' (emphasis added)[4]

Greenblatt, 240 F.2d at 246 (*citing* C.C.C.P. 1181 (*repealed by* C.C.C.P. 1362 § 3, operative January 1, 1971)).

In contrast to California's statute, which provided a lien without the prerequisite of complying with filing and notice procedures, the rights provided to a subcontractor under North Carolina are conditioned on the subcontractor taking certain actions that were not taken by United Rentals in this case. App. A, pp. 15a-17a. The Fourth Circuit held that "[b]ecause United had not filed such a claim when the transfers were made, no interest had been transferred to United, and United had no such interest to release." App. A., p. 17a. Based on the differences in state law, the Ninth Circuit did not decide whether forbearance of the mere right to obtain a lien constitutes "new value".

[4] United Rentals cites N. C. Gen. Stat.§44A-18 as stating that North Carolina law gives a subcontractor " a lien upon funds that are owed to the contractor with whom the . . . . subcontractor dealt. . . ." United Rentals omitted that the statute provides that the lien is conditioned "(u)pon compliance with this Article" *See* Brief, p. 7; *compare* N.C. Gen. Stat.§44A-18. United Rentals' failure to give proper weight to the specific provisions of North Carolina law governing materialmen's liens is demonstrated by its failure to include those provisions in its statement of the Statutory Provisions Involved. Brief, pp. 2-3.

III. *The decision below does not implicate decisions of national importance.*

Lien laws. Creditors' entitlements in bankruptcy arise from the underlying substantive law creating the debtor's obligation, subject to any qualifying or contrary Bankruptcy Code provisions. *See Butner v. United States*, 440 U.S. 48, 55, 59 L. Ed. 2d 136, 99 S. Ct. 914 (1979). The basic federal rule in bankruptcy is that state law governs the substance of claims. *Id.* at 57; *Raleigh v. Ill. Dep't of Revenue*, 530 U.S. 15, 19, 147 L. Ed. 2d 13, 17, 120 S. Ct. 1951, 1955 (2000). Therefore, the rights of United Rentals as to materialmen's liens are governed by North Carolina's lien laws.

United Rentals attempts to create issues of national importance by ignoring specific provisions of North Carolina's lien laws and by categorically referring to North Carolina's lien law and lien laws of other states available to equipment lessors on construction projects as "inchoate mechanic's lien rights" and "state created lien rights." Brief, p. 29. As found by the Fourth Circuit, North Carolina's lien laws provide "only a right to file a mechanic's lien, which United did not do here." App. A, p. 16a. In contrast, other states have laws that grant liens without conditions, such as the California statue cited in *Greenblatt*, above. North Carolina's lien law provisions and the substantive rights of subcontractors thereunder are limited in applicability to the scope of the statutes, *see* N.C. GEN. STAT. Chapter 44A, Articles 1-3, are not uniform with the laws of other states and are not nationwide in their application.

Furthermore, a subcontractor has the ability to avoid the application of the Fourth Circuit decision by exercising its lien rights to obtain the benefits of the liens provided to them under N.C. General Statutes, Chapter 44A. The ordinary course of business defense under 11 U.S.C. § 547(c)(2)[5] will provide a defense for subcontractors receiving payments in the ordinary course, but if payment is not made in the ordinary course, then the subcontractor has a remedy at law available to it to obtain a lien by complying with North Carolina's statutory provisions. This case should not be elevated to review by the highest Court in the land simply because United Rentals chose not to exercise its rights under state law, and asserts a "decision of national importance" because it chooses, with knowledge of the Fourth Circuit's ruling, not to exercise those rights in the future. The right that United Rentals contends to be of national importance is the right to retain a preferential payment in cases where it has leased equipment on construction projects in North Carolina and knowingly refuses to assert the rights granted to it under North Carolina lien laws to protect its rights to payment.

Furthermore, United Rentals has failed to show any case without distinguishing facts from any other circuit allowing the § 547(c)(1) new value defense. The Second Circuit cases interpreting *Ricotta* hold that it is irrelevant to the new value defense or to cases in which the creditor asserts a lien against property that is not property of the debtor. The Ninth Circuit case of

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[5] United Rentals did not assert the ordinary course of business defense under 11 U.S.C. § 547(c)(2) in this case.

Greenblatt is based on a now-repealed statue that grants an absolute lien without notice provisions. United Rentals has simply cited no conflicting Circuit Court decision on point.

Bond claims. Similarly, the "decision of national importance" as to bond claims is the right to retain a preferential payment in cases where it has leased equipment on construction projects and knowingly refuses to assert a claim against the surety that agreed to pay its claims. The alleged damage to United Rentals in having to return the preferential payment is uncertain in view of the ability of United Rentals to make a contingent bond claim against the surety for payments made within the preference period – possibly providing it with a source of recovery even if the preference payment is avoided.

Public Policy. As to both issues, United Rentals asserts that the Fourth Circuit's holding will encourage creditors to file lien claims and assert bond claims to avoid bankruptcy preference claims would disrupt projects and business relations, generate legal fees and consume court resources, while promoting rather than preventing dismemberment of the debtor during his slide into bankruptcy. Brief, p. 35. Certainly, the Miller Act, the little Miller acts and the North Carolina lien laws were enacted by the legislatures to allow subcontractors and suppliers, such as United Rentals, the legal means to protect themselves in the event of nonpayment by a contractor or owner. They make remedies available to subcontractors to better their positions by obtaining rights to payment from third

parties or liens and encourage the very acts that United Rentals contends to be the evils that the Fourth Circuit Decision fosters.

Just as one unsecured creditor may obtain a judgment against a debtor while another does not, or a creditor may require security as a condition not extending credit while another does not, United Rentals is in the position of a creditor that, having remedies available to it, failed to exercise them. There is no public policy that would bestow upon United Rentals the benefits of remedies that it did not exercise to avoid the bankruptcy policy of making pro rata distributions to similarly situated creditors. To the contrary, allowing United Rentals, who did nothing to protect its position to change its position from an unsecured creditor to a secured creditor to reap the benefits of a security interest it did not have or an equitable lien that the surety did not have would be contrary to the equality of distributions among unsecured creditors.

CONCLUSION

The cases relating to §547(b)(5) are not in conflict and the conflicting rules of decision cited by United Rentals are uniformly found to be compatible in the same circuits. The "100% rule" applicable to unsecured creditors applies to United Rentals because it was found to be an unsecured creditor ad is a specific application of the ":diminution" rule.

As to the issues under § 547(c)(1), United Rentals did nothing to assert claims against bonding companies on the projects or to obtain liens that are available under

North Carolina law. This was the factual basis of the Fourth Circuit decision and was integral to its legal conclusions. In arguing that there are conflicts between the circuits, United Rentals relies on cases in which creditors had actual liens or asserted claims against bonding companies. These cases are not controlling in their circuits as to § 547(c)(1) in cases where no bond claims had been asserted and there were no liens. There are simply no circuit court decisions cited by United Rentals that are factually on point with the Fourth Circuit decision.

The issues involved are not of national significance, since North Carolina's lien laws are specific to North Carolina and a creditor may protect itself by utilizing its remedies to make bond claims or file liens. United Rentals' petition for certiorari should be denied.

Respectfully submitted,

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